Top Consumer Bankruptcy Cases
Delaware, Pennsylvania and New Jersey
June 1, 2019- November 1, 2020[1]

Supreme Court
Civil Contempt

Taggart v. Lorenzen, 139 S. Ct. 1795, --- U.S. --- (2019). After receiving his chapter 7 discharge, an Oregon court issued a judgement including attorney fees against the discharged debtor. The debtor moved in bankruptcy court to hold the plaintiffs in contempt and for sanctions for willfully violating the debtor's chapter 7 discharge. The defendants countered with the argument that the creditor's good faith belief the discharge did not apply to them precluded a finding of contempt. A portion of the attorney fee award involved fees incurred by the plaintiffs post-petition. Based upon a 9th Circuit case *In re Ybarra*, 424 F. 3d 1018 (2005) where the court held that if an underlying contract had an attorney fee clause, if the debtor "returns to the fray" post-petition, the debtor can be liable for the post-petition fees.

The Supreme Court framed the issue thusly: "The question presented here concerns the criteria for attempting to collect a debt that a discharge order has immunized from collection." The Court held that: "…a court may hold a creditor in civil contempt for violating a discharge order if there is *no fair ground of doubt* as to whether the order barred the creditor's conduct. In other words, civil contempt may be appropriate if there is no objectively reasonable basis for concluding that the creditor's conduct might be lawful" Later in the opinion, the Court stated the proposition in the converse: "Under the fair ground of doubt standard, civil contempt therefore may be appropriate when the creditor violates a discharge order based on an objectively unreasonable understanding of the discharge order or the statutes that govern its scope."

In reaching these conclusions, the Court first noted that Section 727(a) and discharge orders are rather sparse, requiring reference to Section 523(a) and the list of debts that are not dischargeable. Next, the Court noted that traditional standards in equity practice to determine when a party is in civil contempt for violating an injunction: "In cases outside the bankruptcy context, we have said that civil contempt 'should not be resorted to where there is [a] *fair ground of doubt* as to the wrongfulness of the defendant's conduct."

Although the Court noted the strict liability aspects of willful automatic stay violations, the court rejected a strict liability standard in imposing civil contempt for violations of a debtor's discharge.

Denial of Discharge

In re Cowan, 2019 WL 5615968 (Bankr. N.J.) In 2013, the Debtor formed Price Home Group. He had previously operated other business through the years. Home Group became an N.J. general home contractor and worked significantly with the NJ organization responsible for hiring contractors to rebuild homes after Hurricane Sandy in 2012. Home Group wound down its operations in late 2015. The Debtor filed an individual Chapter 11 in March 2016. He misstated his income in his SOFA. A report

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prepared by accountants for Home Group identified irregularities in the company financials and material misstatements in its projections. In June 2016 the State of New Jersey filed an adversary complaint against the debtor for fraud. The debtor later entered into a Consent Judgement. The Chapter 11 was converted to Chapter 7 in November 2016. It was learned that Home Group relied only upon QuickBooks for its accounting, that Home Group had not filed tax returns for 2015. The U.S. Trustee objected to the debtor's discharge based upon Section 727(a)(3), a failure to keep adequate books and records from which the debtor's financial affairs can be ascertained.

In denying the debtor his discharge upon cross motions for summary judgement, the court first reviewed each party's necessary burden of proof: "Debtor must show US failed to meet its burden and UST must show by a preponderance of the evidence that it did." The court then restated the factors typically considered when analyzing a Section 727(a)(3) complaint: "Justification depends largely on what a normal, reasonable person would do under similar circumstances…When a debtor is unsophisticated or lacks experience in financial recordkeeping, courts have set a lower threshold for justification."

The Court found that: "Clearly Debtor is a sophisticated businessman with complex business interests despite being unsuccessful with Home Group…[it] appears Debtor made every effort to obfuscate his records by providing a lot of meaningless, unreliable, and conflicting information." Discharge denied.

Eligibility to File

In re Cyrilla, 2020 WL 96680 (Bankr. W.D. PA). On January 2, 2018, the debtor filed Chapter 11, owing secured debt of $1,143,641 and unsecured debts of $496,692. This was his fifth filing. After more than a year, his case was converted to chapter 7 for failure to file monthly operating reports. The debtor then moved to convert his case to Chapter 13. Creditors opposed, contending that the debtor was ineligible for Chapter 13 when he filed his petition in 2018. The debtor contended the court should look at his debts on the conversion date.

The debtor was wrong. Section 706(d) requires that a debtor be eligible to be a debtor in the chapter conversion to is desired. Section 348(a) provides that when a case is converted from one chapter to another the case retains its original filing date. When the debtor filed, he admitted his debts exceeded the then chapter 13 filing limits. Because he was ineligible to file Chapter 13 on the original filing date, he could not convert his case to a Chapter 13.

Unauthorized Post-Petition Transfers/ Attorney Misconduct

In re Hopkins, 2019 WL 6357249 (Bankr. NJ). Mr. Hopkins filed for Chapter 13 relief on September 10, 2018. On February 25, 2019, the case was dismissed for failure to file, statements, schedules, income or even a plan. The dismissal was vacated on April 2, 2019. On April 4, 2019, debtor's counsel filed a Notice of Proposed Private Sale proposing to sell real estate for $42,000 and to pay a broker 3% plus $50. He did not file a motion to sell in compliance with D.N.J. LBR 6004-1(c). In his late filed schedules, the debtor valued the property at $85,000. The trustee objected to the sale and requested a turnover of net proceeds as the debtor did not claim the property exempt. The Debtor

then filed a motion to approve the sale. The holder of a tax certificate objected to the sale as well. Then, at a hearing held on July 16, 2019, the debtor disclosed that the sale had closed on July 1, 2019 and for $32,000. Counsel for the debtor seemed to have no idea the debtor or he had done anything wrong. Meanwhile, the debtor spent the net proceeds of the sale.

The Court did not dismiss the case. Instead, the Court ordered the Debtor to file an amended plan satisfying secured claims against the property and the debtor to pay $600 for 16 months for all creditors to be paid in full. The Court also admonished counsel for his conduct of the case: "… Mr Ford's and Mr. Hopkins' pleadings and arguments, egregious conduct, and complete lack of attention to details reflect an abuse of, and blatant disregard for, the bankruptcy system indicating bad faith and warranting sanctions." In disallowing counsel's fees, the Court stated: "…it is clear to the court that Mr. Ford's representation of Mr. Hopkins was gravely lacking."

Willful Stay Violation/ Violation of Discharge Injunction

In re Krisiak, 613 B.R. 606 (Bankr. M.D. Pa. 2020). Debtor obtained loan from credit union in 2016. Shortly after the loan was obtained, the credit union changed its address. In April of 2019 the debtor filed Chapter 7, listing the credit union at the original address. On August 5, 2019, the credit union filed a collection action against the debtor. On August 12, 2019 the debtor received his discharge. On September 4, 2019, the debtor filed an Adversary Complaint alleging violation of the automatic stay and the discharge injunction. On September 13, 2019, the credit union dismissed the collection action with prejudice. The credit union contended, alleging the address change, that service of the Adversary Complaint was the first knowledge it had of the bankruptcy filing and that it promptly dismissed the collection action.

In denying the credit union's motion for summary judgement, the Court held that it was a material question of fact as to whether the credit union did or did not have knowledge of the bankruptcy when it filed the collection action. Because the Court noted that it was not yet ruling on the alleged violation of the discharge injunction: "…the Court need not undergo a *Taggart* 'no fair ground of doubt' analysis."

Individual Chapter 11- Absolute Priority Rule

In re LaForgia, 2019 WL 4894870 (Bankr. N.J. 2019) Debtor filed a chapter 11 plan which proposed to pay unsecured claims a 2% dividend over five years. The plan also proposed that the debtors would retain all their assets. The IRS objected on grounds including the plan violated the absolute priority rule requiring that the debtor retain no non-exempt assets unless all senior classes are paid in full, absent class consent.

The court identified the views on the issue of whether the BAPCPA amendments affecting individual Chapter 11 abrogated or did not abrogate the absolute priority rule. Five circuits have held that the amendments did not affect the absolute priority rule in individual cases. Under this majority rule, an individual debtor must pay all disposable income for five years, and account as well for the full value of any non-exempt assets. A

minority rule takes the position that a debtor may retain non-exempt property. The Third Circuit has not ruled on the issue.

Taking the majority view, the court holds that BAPCPA did not abrogate the absolute priority rule in individual chapter 11 cases. The court observed that if Congress had intended to do so, it could have added language elsewhere, could have raised the chapter 13 debt limits, and third, that the repeal of something as sacrosanct as the absolute priority rule would have to be express, concluding: "But when BAPCPA is viewed as a whole, it is clear that Congress intended to make things harder for all debtors, not just individual chapter 11 debtors."

Pleading Standards

In re Lewis, 2019 WL 5777676 (Bankr. E.D. PA) In partially granting and partially denying a motion to dismiss, the court applies the pleading requirements imposed under what has become known as the *Twombley Iqbal* standard (*Bell Atlantic Corp v. Twombley*, 550 U.S. 570 (2007); *Ashcroft v Iqbal*, 129 S. Ct. 1937 (2009): "To prevent dismissal, all civil complaints must set out 'sufficient factual matter' to show that the claim is facially plausible. The plausibility standard requires more than a mere possibility that the defendant is liable for the alleged misconduct. As the Supreme Court instructed in *Iqbal*, 'where the well-pleaded facts do not permit the court to infer more than the mere possibility of misconduct, the complaint has alleged- but has not 'show[n[-that the pleader is entitled to relief.'" Where there were no facts to demonstrate that various defendants had a relationship with the plaintiffs, the defendants were dismissed. Where there was evidence of contracts between the plaintiffs and various defendants, those counts survived the motion to dismiss.

Objection to Dischargeability

In re Mason, 2019 WL 3849291 (Bankr, NJ) The debtor and his law firm represented Michael Attardi. Attardi, a screen writer and Joseph Anselmo, an aspiring producer, hired Mason and his law firm to represent them in exchange for two percent of the equity in the various companies formed. Attardi began work on a script entitled, "Numba One", a live action mafia comedy. Anselmo found several persons who in late 2010 invested $690,000 in the film, the funds to be held in escrow unless commitments totaling $3 million were made by September 11, 2011. The funds were placed into the debtor's firm's trust account.

In January 2011 Attardi and Mason were scammed, or as the Court put it: "The details of this transaction are dubious and so the Court will relay them as put forward in Defendant's pleading." Basically, the debtor and Attardi were convinced to part with the $690,000 in exchange for dubious returns in an investment they did not undertake due diligence for and did not seek the consent of the other investors. The money was gone by the end of January 2011. In October of 2016, Mason entered into a consent judgment in favor of the plaintiff investors in the amount of $890,000. Mason filed chapter 7 in 2017. The investors sought to deny dischargeability of the judgement of under 11 U.S.C. §§ 523(a)(2)(4)(6). At the conclusion of the trial the court dismissed subsectons (a) (2) and (6) from the complaint but ruled in favor of the plaintiffs on the 523(a)(4) allegations.

To prove a claim under Section 523(a) (4), the plaintiff must show three elements, all of which were present here:

1. The debtor must have a fiduciary duty to the creditor. An attorney is a fiduciary to the client and here there was also an express trust and escrow agreement which also acted to create a fiduciary duty.
2. There must be a defalcation. Here, using the funds without authorization and without conducting any due diligence of the underlying transaction.
3. The plaintiffs suffered damages of $690,000.

Discharge Violations- Governmental Entity

In re Moss, 618 B.R. 123 (Bankr. NJ 2020) The debtor filed Chapter 13 in December 2012, listing the Neptune Township Municipal Court as a creditor for unpaid fines. In 2013, the Court entered a self-executing order reinstating the debtor's driver's license. In November 2016 the debtor received his discharge. Neptune, however, still reported the debtor's fines. The debtor reopened the case in 2018 and the Court entered a second order directing Neptune to correct its records. In December 2019 Neptune notified the debtor that a warrant for his arrest would be issued if the fines were not paid by January 2020. The Debtor filed his adversary proceeding in October 2019 seeking damages for violation of the stay and discharge orders. The damage allegations included damages for "mental and emotional harm".

The Court easily finds that the fines were discharged through the Chapter 13. The remaining issues were whether the continuing notices violated the discharge and the extent, if any, of Sovereign Immunity in favor of Neptune.

As to the first issue, municipal court fines are dischargeable if the plan is successfully performed. The fine was discharged by the successful chapter 13.

Next, the Court examined whether Neptune could be held in contempt. Applying the standard set forth in *Taggart v Lorenzen,* supra:

> "…[a] court may hold a creditor in civil contempt for violating a discharge order where there is not a 'fair ground of doubt' as to whether the creditor's conduct might be lawful under the discharge order.
>
> "Applying the Supreme Court's articulated objective standard as outlined in Taggart, this Court determines it is unassailable that Defendant's attempts to enforce the pre-petition municipal fines were unlawful, both subjectively and objectively."

The Court finds Neptune in contempt and next turns to the issue of Sovereign Immunity. Section 106(a) of the Bankruptcy Code unequivocally waives Sovereign Immunity for issues relating to the automatic stay and discharge. However, Sovereign Immunity is not waived for punitive damages or for emotional damages.